[JOINT COMMITTEE PRINT]

OVERVIEW OF FEDERAL TAX TREATMENT OF LIFE INSURANCE COMPANIES AND 1988 INTERIM TREASURY DEPARTMENT REPORT

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON SEPTEMBER 27, 1988

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has scheduled a public hearing on September 27, 1988, on certain aspects of life insurance company taxation.

The Subcommittee hearing will review the provisions governing the taxation of life insurance companies which were substantially revised in the Deficit Reduction Act of 1984 ("1984 Act"). The hearing will focus on preliminary data on the amount of Federal income taxes paid by the life insurance industry (mutual life insurance companies and stock life insurance companies) since enactment of the 1984 Act. The Subcommittee will consider the June 1988 *Interim Report to the Congress on Life Insurance Company Taxation*, prepared by the Treasury Department, which was mandated in the 1984 Act.

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation in connection with the Subcommittee hearing, provides an overview of the Federal tax treatment of life insurance companies and the 1988 interim Treasury Department report.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Overview of Federal Tax Treatment of Life Insurance Companies and 1988 Interim Treasury Department Report* (JCS-16-88), September 23, 1988.

I. SUMMARY

Present Law

The Deficit Reduction Act of 1984 ("1984 Act") contained provisions limiting the deduction for policyholder dividends paid by mutual life insurance companies. The Congress determined that a reason for these provisions was that, because a mutual company's policyholders are also owners of the company, a portion of the policyholder dividends paid to them represent a return of company profits (i.e., a return of capital). In addition, these provisions were designed to ensure that mutual life insurance companies would pay 55 percent of the total Federal income tax collected from the life insurance industry. For mutual life insurance companies, the amount of the deduction for policyholder dividends is reduced by the "differential earnings amount." This amount is computed by multiplying the company's average equity base for the taxable year by the "differential earnings rate" for the taxable year. The differential earnings rate is the excess of the "imputed earnings rate" over the "average mutual earnings rate". As explained below, the "imputed earnings rate" is designed to provide comparable treatment for stock and mutual companies.

The imputed earnings rate for 1984 was 16.5 percent. For taxable years beginning after 1984, the imputed earnings rate is an amount which bears the same ratio to 16.5 percent as the current stock earnings rate (i.e., the numerical average of the rates of return for the 50 largest stock companies for the preceding 3 taxable years) bears to the base period stock earnings rate (i.e., the numerical average of the rates of return for the 50 largest stock companies for 1981, 1982, and 1983). The average mutual earnings rate for any year is the weighted average of the rates of return for all mutual companies.

Life Insurance Industry Studies Mandated by the 1984 Act

Two issues that were of concern during the process of reformulation of the tax treatment of life insurance companies in 1984 were (1) the amount of Federal income tax paid by the life insurance industry, and (2) the relative Federal income tax burden borne by mutual and stock life insurance companies. The Congress determined that these issues should be closely scrutinized and thus, the 1984 Act instructed the Treasury Department to prepare reports on these two issues. The first interim report to the Congress was provided by the Treasury Department on June 15, 1988.[2]

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[2] Department of the Treasury, *Interim Report to the Congress on Life Insurance Company Taxation*, June 1988 ("1988 Treasury Report").

Interim Treasury Department Report

The 1988 Treasury Report concludes that the Federal income tax payments of the life insurance industry and the relative share of tax paid by the mutual and stock segments in 1984 and 1985 did not meet estimates made at the time of the 1984 Act.

Several factors should be considered in interpreting the Treasury Report data. First, the data are preliminary and have not been fully verified by the Treasury Department. Second, the data do not reflect amendments and audit adjustments to 1984 and 1985 tax returns made after the date of the 1987 Treasury Survey. Third, the revenue estimates are shown on a consolidated return basis. Fourth, the data do not include taxes paid by stockholders of life insurance companies (policyholders in the case of mutual life companies) with respect to such stock. Last, tax minimizing behavior in the life insurance sector, such as an increase in tax exempt bond ownership, may increase tax liability in other sectors (as a result of reduced ownership of tax exempt bonds in these sectors). Thus, a portion of the revenue change attributable to the insurance provisions of the 1984 Act could be reflected on the tax returns of taxpayers other than insurance companies.

A summary of the 1988 interim Treasury Report is in Part III.

II. PRESENT-LAW RULES RELATING TO THE TAX TREATMENT OF LIFE INSURANCE COMPANIES

A. 1984 Act Changes

The Deficit Reduction Act of 1984 ("1984 Act") restructured the Federal income tax treatment of life insurance companies by replacing a three-phase tax structure with a single-phase structure. The single-phase tax structure was based on a stock life insurance company model in order to provide a relatively simple tax structure for life insurance companies that bore a close resemblance to the general tax treatment of corporations. In addition, the choice of the stock company model reflected the view that life insurance companies should be subject to tax at corporate rates.

The 1984 Act also contained provisions limiting the deduction for policyholder dividends paid by mutual life insurance companies. One reason for these provisions was that, because a mutual company's policyholders are also owners of the company, a portion of the policyholder dividends paid to them was considered to represent a return of company profits (i.e., a return of capital). In addition, these provisions were designed to ensure that mutual life insurance companies would pay 55 percent of the total Federal income tax collected from the life insurance industry in 1984.

B. Definition of a Life Insurance Company

Under present law, a life insurance company is defined as an insurance company that is engaged in the business of issuing life insurance contracts, annuity contracts, or noncancellable accident and health insurance contracts if more than 50 percent of the total reserves of the company are life insurance reserves or unearned premiums and unpaid losses on noncancellable life, accident, or health contracts that are not included in life insurance reserves. For purposes of this definition, an insurance company is any company for which more than half of the business activity of the company during the year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

Whether more than half of the business activity of a company is the issuing of insurance or annuity contracts depends on the facts and circumstances. Factors to be considered include the number of employees assigned to, the amount of space allocated to, and the net income derived from, the various business activities. The character of the business actually carried on in the taxable year determines whether a company is taxed as an insurance company.[3]

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[3] *See, e.g., Service Life Insurance Co.* v. *United States*, 189 F. Supp. 288, *aff'd. on other grounds*, 293 F.2d 78 (9th Cir. 1961).

C. Computation of Life Insurance Company Taxable Income

Life insurance company taxable income

A life insurance company is taxed at corporate rates on its life insurance company taxable income (LICTI). LICTI is life insurance gross income reduced by life insurance deductions. A stock life insurance company is also taxed, at corporate rates, on any distributions from a pre-1984 policyholders' surplus account.

Life insurance gross income is the sum of (1) premiums, (2) decreases in certain reserves, and (3) other amounts generally includible by a taxpayer in gross income. For these purposes, premiums consist of the gross amount of premiums and other consideration received on insurance and annuity contracts reduced by return premiums paid to policyholders, such as on the cancellation of a policy, and premiums and other consideration paid to another insurer on indemnity reinsurance.

The premiums and other consideration taken into account include advance premiums, deposits, fees, assessments, consideration in respect of assuming liabilities under contracts not issued by the taxpayer, and any policyholder dividends reimbursable by a reinsurer. Return premiums do not include amounts paid to policyholders that are not fixed in the contract but depend on the experience of the company or the discretion of the management, except in the case of return premiums or other consideration returned to another life insurance company under an indemnity reinsurance contract. Amounts rebated or returned due to policy cancellations or to erroneously computed premiums are to be treated as return premiums.

General deductions

Life insurance companies are allowed deductions for (1) claims and benefits accrued, and losses incurred (whether or not ascertained) during the taxable year on insurance and annuity contracts, (2) net increases in reserves, (3) policyholder dividends, (4) dividends received by the company (limited to the company's share), (5) operations losses, (6) consideration paid for assumption reinsurance, and (7) policyholder dividend reimbursements paid to another insurance company under a reinsurance agreement. In addition, life insurance companies are allowed other deductions generally allowable to corporate taxpayers for purposes of computing taxable income, subject to certain modifications.

Small life insurance company deduction

Small life insurance companies are allowed an additional special deduction that is not available to other taxpayers. The amount of the deduction is 60 percent of so much of tentative LICTI for such taxable year as does not exceed $3 million, reduced by 15 percent of the excess of tentative LICTI over $3 million. The small life insurance company deduction is only allowable to companies with gross assets of less than $500 million.

Deductions with respect to reserves

In general, life insurance companies are allowed a deduction for a net increase in reserves and must take into income any net de-

crease in reserves. In general, the net increase or net decrease in reserves is computed by comparing the closing balance of the reserves to the opening balance of the reserves, with the closing balance of the reserves becoming the opening balance for the following year.

In computing the net increase or net decrease in reserves, the closing balance of the reserve items is reduced by the policyholders' share of tax-exempt interest. A life insurance company's reserve liability to its policyholders in effect entitles the policyholders to a pro rata portion of each item of investment income, including tax-exempt income.

In computing the net increase or net decrease in reserves, the following six items are taken into account: (1) life insurance reserves; (2) unearned premiums and unpaid losses included in total reserves; (3) amounts that are discounted at interest to satisfy obligations under insurance and annuity contracts which do not involve life, accident, or health contingencies when the computation is made; (4) dividend accumulations and other amounts held at interest in connection with insurance and annuity contracts; (5) premiums received in advance and liabilities for premium deposit funds; and (6) reasonable special contingency reserves under contracts of group-term life insurance or group accident and health insurance that are held for retired lives, premium stabilization, or a combination of both.

For purposes of determining life insurance company taxable income, the life insurance reserve for any contract is the greater of the net surrender value of the contract or the reserve determined under Federally prescribed rules. In no event may the amount of the tax reserves at any time exceed the amount of the statutory reserves, which include any deficiency reserves relating to the liabilities. The net surrender value is the cash surrender value reduced by any surrender penalty, except that any market value adjustment required on surrender is not taken into account.

In computing the Federally prescribed reserve for any contract, the tax reserve method applicable to that contract must be used, along with the prescribed interest rate and the prevailing commissioners' standard tables for mortality or morbidity. Thus, in computing the Federally prescribed reserve, a company begins with its statutory or annual statement reserve, and modifies that reserve to take into account the prescribed method, the prescribed interest rate, the prevailing mortality or morbidity table, as well as the elimination of any net deferred and uncollected premiums and the elimination of any reserve in respect of "excess interest" guaranteed beyond the end of the taxable year. Except for the Federally prescribed items, the methods and assumptions employed in computing the Federally prescribed reserve are to be consistent with those employed in computing a company's statutory reserve. However, to avoid State-by-State variations, the prescribed rules are based on the general guidelines recommended by the National Association of Insurance Commissioners (NAIC) and adopted by a majority of the States.

In general, the Federally prescribed reserve methods refer to those recommended by the NAIC for a particular type of contract. There is no requirement that the method also be required based on

the prevailing view of the States. Thus, as a general rule, in computing any life insurance reserve, a company is required to take into account any factors specifically recommended by the NAIC. If specific factors are not recommended by the NAIC prescribed reserve method, the prevailing State interpretation of such method is considered for purposes of determining what factors are to be taken into account in applying the computation method for tax purposes.

Interest rates

The interest rate to be applied in determining the amount of the life insurance reserves for any contract is the greater of the applicable Federal interest rate or the prevailing State assumed interest rate for the calendar year in which the contract is issued. The applicable Federal interest rate is the rate determined under the discounting rules for property and casualty reserves for the calendar year in which the contract is issued. The "prevailing State assumed interest rate" means, for any contract, the highest assumed interest rate permitted to be used in at least 26 States in computing life insurance reserves for insurance or annuity contracts of that type as of the beginning of the calendar year in which the contract is issued.

In the case of reserves for contracts that do not involve life, accident, or health contingencies, the interest rate to be applied is the greatest of (1) the applicable Federal interest rate, (2) the prevailing State assumed interest rate, or (3) the rate assumed by the company in determining the guaranteed benefit.

Under present law, life insurance companies are allowed a one-time election (revocable only with the consent of the Secretary of the Treasury) to apply an updated applicable Federal interest rate every 5 years in calculating life insurance reserves. The election is provided to take account of the fluctuations in market rates of return that companies experience with respect to life insurance contracts of long duration.

Under the election, the rate in effect in the year in which a contract is issued continues to be applied in the 4 succeeding years after the year the contract is issued. For the 5th through 9th year after the contract is issued, the rate to be applied in determining reserves for such years (but not for any prior years) with respect to the contract is the greater of the applicable Federal interest rate for such 5th year or the prevailing State assumed interest rate for the calendar year in which the contract was issued. Thus, the rate for determining life insurance reserves with respect to any contract cannot be lower than the prevailing State assumed interest rate for the calendar year in which the contract was issued.

The use of the updated applicable Federal interest rate under the election does not cause the recalculation of life insurance reserves for any prior year. Thus, for example, if an updated rate is applied to calculate life insurance reserves in the 10th year following the year in which the contract was issued, the amount of the company's life insurance reserves, and its deduction for additions to reserves, for the preceding 10 years are not affected.

Section 807(f), which generally provides a 10-year spread for any change in computing reserves, does not apply to the use of an updated applicable Federal interest rate under the election. Instead,

the difference between the opening reserve computed under the old interest rate and the opening reserve computed under the new interest rate is to be taken into account entirely for the year in which the new interest rate applies.

Under the election, no change is made to the interest rate used in determining life insurance reserves if the updated applicable Federal interest rate is less than one-half of one percentage point different from the rate utilized by the company in calculating life insurance reserves during the preceding 5 years. Thus, for example, if the applicable Federal interest rate is 7.5 percent, and the rate utilized by an electing company during the preceding 5 years is 7.6 percent, the company continues to use the 7.6 percent rate during the second 5-year period with respect to reserves for that contract year. This rule parallels the calculation of State assumed rates under the Standard Valuation Law, under which a change of less than one-half of one percentage point does not give rise to a change in the State assumed rate.

The election applies to all contracts issued during the calendar year for which the election is made and any subsequent calendar year unless the election is revoked with the consent of the Secretary of the Treasury.

Mortality tables

The prevailing commissioners' standard tables for mortality or morbidity to be used for computing the Federally prescribed reserves are, with respect to any contract, the most recent tables prescribed by the NAIC and permitted to be used for that type of contract in computing reserves under the laws of at least 26 States when the contract is issued. If a table becomes a prevailing commissioners' standard table during a calendar year, then the new table may be used as the prevailing table from the beginning of the calendar year. Generally, when mortality and morbidity tables are being updated and adopted by the States, companies will have 3 full years after a particular set of tables becomes the prevailing view of the States before such table becomes mandatory for computing reserves for tax purposes.

Deductions for policyholder dividends

Present law allows a deduction for dividends or similar distributions to policyholders. The amount of the deduction for any taxable year is the amount of policyholder dividends paid or accrued during the taxable year.

In general, policyholder dividends are dividends and similar distributions to policyholders, but not return premiums. The term "policyholder dividends" generally refers to amounts returned to policyholders that are not fixed in the contract, but depend on the experience of the company or the discretion of management.

The term policyholder dividends includes any distribution to a policyholder that is the economic equivalent of a dividend. Thus, in addition to any amount paid or credited to policyholders (including an increase in benefits) that is not fixed in the contract but depends on the experience of the company or the discretion of management, the term policyholder dividends specifically includes

excess interest, premium adjustments, and experience-rated refunds.

The term "excess interest" means any amount in the nature of interest that is paid or credited to a policyholder and determined at a rate in excess of the prevailing State assumed interest rate for the contract. Amounts in the nature of interest include all amounts paid for the use of money regardless of the particular designation adopted by the payor or payee. Thus, amounts in the nature of interest include interest payments with respect to amounts left on deposit and amounts paid in lieu of interest, such as in the case of origination or service fees. Similarly, amounts in the nature of interest include amounts calculated as interest (e.g., the increase in reserves or cash surrender values attributable to assumed or guaranteed interest rates rather than premium contributions). Thus, for example, any increase in the cash surrender value of a contract above that which would result if the prevailing State assumed interest rate were used to compute the increase is treated as excess interest.

The term "premium adjustment" means any reduction in the premium under an insurance or annuity contract which, but for such reduction, would have been required to be paid under the contract. If no premium amount is fixed in the contract, variations in premiums paid during the course of the contract are not considered premium adjustments. Further, a change in the amount of a premium that is attributable to the insurability of the insured is not considered a premium adjustment.

Finally, the term "experience-rated refund" means any refund or credit based on the experience of the contract or group involved. Thus, for example, if a company sells a group policy to an employer covering the lives of its employees and the premiums received exceed the sum of the claims paid and other expenses, any refund of such excess is an experience-rated refund. Any policyholder dividend that increases any of the benefits payable under the contract (including the cash surrender value), or reduces the premium otherwise required, is treated as paid to the policyholder and returned by the policyholder to the company as a premium.

D. Deductions of Mutual Life Insurance Companies

In general

Although the general rules and definitions relating to policyholder dividends apply to stock and mutual life insurance companies alike, for mutual companies, the amount of the deduction for policyholder dividends is reduced by the "differential earnings amount." If the differential earnings amount exceeds the allowable deduction, then the excess reduces the closing balance of the company's reserves. This reduction reflects the Congress' determination in 1984 that, to some extent, policyholder dividends paid by mutual companies are distributions of the companies' earnings to policyholders as owners.

Because a mutual company's policyholders are also the owners of the enterprise, policyholder dividends paid to them are distributions from the company that are a combination of price rebates, policyholder benefits, and returns of company profits. Although

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there is no precise way to segregate a policyholder dividend or other payment into these various components, the Congress concluded that profit-oriented enterprises tend to distribute earnings to their owners in amounts that are proportional to the owners' equity in the business. Thus, the Congress determined that the portion of a policyholder dividend that is a distribution of earnings can be measured as a percentage of the mutual company's equity (the "average equity base"). To determine the appropriate percentage of the equity base, the post-dividend rates of return on equity for both stock and mutual companies were examined. The average post-dividend, pre-tax return on equity of mutual companies was less than the average post-dividend, pre-tax return on equity for a comparable group of stock companies at and prior to the time the reduction in mutual company deductions was enacted. The Congress concluded that this difference was attributable to distribution by mutual companies of earnings to their owners.

This approach to identifying ownership distributions by a mutual company is given effect by means of a reduction in the policyholder dividends deduction by a "differential earnings amount." This amount is computed by multiplying the company's average equity base for the taxable year by the "differential earnings rate" for the taxable year. The differential earnings rate is the excess of the "imputed earnings rate" for a taxable year over the "average mutual earnings rate" for the second calendar year preceding the calendar year in which the taxable year begins. As explained below, the "imputed earnings rate" is designed to provide comparable treatment for stock and mutual companies.

Imputed earnings rate

The imputed earnings rate for 1984 was 16.5 percent. For taxable years beginning after 1984, the imputed earnings rate is an amount which bears the same ratio to 16.5 percent as the current stock earnings rate (i.e., the numerical average of the rates of return for the 50 largest stock companies for the 3 years preceding the current taxable year) bears to the base period stock earnings rate (i.e., the numerical average of the rates of return for the 50 largest stock companies for 1981, 1982, and 1983).

The Congress anticipated that the 16.5-percent rate would result in the mutual segment of the life insurance industry bearing 55 percent of the aggregate industry tax burden for 1984. The Congress believed that this was appropriate in the light of a number of factors including the historic allocation of the industry's tax burden, the relative percentages of assets held by the stock and mutual segments of the industry, and the difference in treatment of mutual company policyholders and stock company shareholders.[4] Because the Congress determined that the 16.5-percent rate resulted in an appropriate allocation of the industry's tax burden for 1984 given these various factors, this rate is adjusted in proportion to changes in the rate of return for large stock companies rather than replacing the imputed rate with one equal to the

[4] Earnings that are distributed by a stock company to its shareholders are included in income by the shareholders. In contrast, in the case of a mutual life insurance company, earnings that are distributed generally are not included in income by the policyholders.

actual rate of return of a group of stock companies in subsequent years. Specifically, the imputed earnings rate was indexed to changes in the current stock earnings rate as compared to the average of the stock earnings rates for a base period of calendar years 1981, 1982, and 1983.

Stock earnings rate

The stock earnings rate for any particular year is the numerical average of the earnings rates of the 50 largest stock life insurance companies. The numerical average of stock earnings rates is used in order to reduce the potential impact of any manipulation of the rate by a few large stock companies. The three-year period is used to preclude the possibility of sharp rises or declines in the rate of return for the stock segment of the industry, giving the mutual companies some ability to plan for and predict tax costs for purposes of marketing their products.

Average mutual earnings rate

The average mutual earnings rate for any year is the weighted average of the rates of return for all mutual companies. The use of an aggregate or weighted average reflects the structure of the ownership differential provision which, in effect, was structured in the 1984 Act to treat the entire mutual segment of the life insurance industry as a taxpaying "entity" required to bear approximately 55 percent of the industry tax burden. The aggregate mutual life insurance company tax burden is statutorily prescribed by the imputed earnings rate of 16.5-percent on equity for 1984 (and as thereafter indexed). The use of a weighted average mutual earnings rate to determine the differential earnings rate ensures that the regular tax (computed without the ownership differential provision and assuming no tax preference items), plus any increase in tax owed due to the application of the ownership differential provision, will meet the prescribed aggregate mutual company tax burden.

Computation of earnings rates

The earnings rate for any life insurance company is to be determined by the Secretary of the Treasury by reference to a company's statement gain or loss from operations as a percentage of its average equity base.

The statement gain or loss from operations is the net gain or loss from operations set forth in the annual statement, determined without regard to Federal income taxes and with further adjustments for certain tax items. First, the statement gain or loss from operations must be adjusted by substituting the amount of the deduction for policyholder dividends for the amount shown on the annual statement for policyholder dividends unreduced by any differential earnings amount. In addition, the statement gain or loss from operations is determined on the basis of tax reserves, rather than statutory reserves.

In calculating the stock earnings rate or the average mutual earnings rate, the Secretary is to take into account companies that may be operating at a loss and, in effect, have a negative rate of return, as well as companies that are operating on a profitable basis. However, in order to eliminate distortions in the computa-

tion of the average earnings rate of the 50 largest stock companies, the Secretary has the authority to omit certain companies that, because of a small equity base (for example, because the company is close to being or is insolvent), would seriously distort the stock earnings rate.

Average equity base

The average equity base of a stock or mutual company is the average of (1) the equity base determined as of the close of the taxable year, and (2) the equity base determined as of the close of the preceding taxable year. The term "equity base" means an amount equal to the statutory surplus and capital plus any nonadmitted financial assets, the excess of statutory reserves over tax reserves, the amount of any mandatory securities valuation reserve, the amount of any deficiency reserve or voluntary reserve, and 50 percent of the amount of any provision for policyholder dividends (or other similar liability) payable in the following taxable year.

The term "nonadmitted financial asset" does not include due and accrued investment income reported as a nonadmitted asset, investments in office furnishings or fixtures, or agents' balances owed to the company. Thus, for example, an amount of due and accrued interest on defaulted bonds is not a nonadmitted financial asset, even though the underlying defaulted bond may be a nonadmitted financial asset. In determining the excess of statutory reserves over tax reserves, the amount of statutory reserves should not include any amount attributable to deferred and uncollected premiums that have not yet been included in life insurance gross income.

Policyholder dividends payable in the following taxable year refers generally to the total amount set aside on the annual statement for apportioned and unapportioned dividends. Only 50 percent of this amount is added to the average equity base because it was believed that, on average, only 50 percent of the total annual statement provision for policyholder dividends to be paid in the following year (whether accrued or unaccrued for tax purposes at the end of the taxable year) is fairly allocable as a liability for the current year. Although a policyholder dividend may be paid at the end of a policy year, and not accrue for tax purposes until payment, recognition of part of that dividend as a current liability to determine the equity of the company recognizes that a dividend that is paid, in theory, accrued to the policyholder in a financial sense over the entire policy year. Once the policyholder dividends have actually been paid (for example, amounts left with the company as dividends on deposit and amounts paid back to the company as premiums), such amounts are not included in policyholder dividends payable in the following taxable year. Likewise, any amounts set aside for policyholder dividends to be paid beyond the close of the following taxable year are not "payable in the following taxable year" and are included in the equity base in their entirety.

Amounts included in equity generally refer to and are valued as amounts shown on the annual statement of the company. However, a classification or characterization of an item on a company's annual statement in an attempt to avoid these requirements is disregarded.

Differential earnings rate

The differential earnings rate for any taxable year is based on a comparison of the imputed earnings rate and the average mutual earnings rate for the second preceding year. This rule is necessary because, for any taxable year, the Secretary will not have the data required to determine the average mutual earnings rate prior to the date a mutual company is required to file its Federal income tax return. However, when actual data becomes available, any difference between the differential earnings amount for the second preceding taxable year is to be taken into account as an addition to or deduction from income (before computation of the small life insurance deduction) for the taxable year during which the Secretary determines the average mutual earnings rate for the prior taxable year. Because any additions to or deduction from income will be taken into account in the first year during which the actual differential earnings rate is recomputed, no interest payments are required. If a company ceases to be a mutual insurance company in any year, then any adjustment will have to be taken into account for the taxable year giving rise to the adjustment.

To simplify the administration of the ownership differential provisions for the initial years covered by the 1984 Act, the Act provided a fixed differential earnings rate of 7.8 percent to be used for purposes of filing returns for the 1984 tax year and for estimated taxes for 1985.

Table 1 contains the various rates necessary to determine the deduction for policyholder dividends of mutual life insurance companies for all years prior to 1988.

Table 1.—Data for Calculation of Section 809 Differential Earnings Rate

[Percent]

Year	Stock Earnings Rate [1]	Current Stock Earnings Rate [2]	Imputed Earnings Rate [3]	Average Mutual Earnings Rate	Differential Earnings Rate [4]	Recomputed Differential Earnings Rate [5]	"True-Up" Rate on Subsequent Year Returns
1987	NA	[6] 18.533	[6] 16.782	NA	[6] 3.647	NA	NA
1986	[6] 20.185	17.983	16.285	[6] 17.985	10.539	[7] 0	[7] −10.539
1985	18.683	18.026	16.323	13.135	6.157	3.188	−2.969
1984	16.731	.....	[8] 16.5	5.746	[8] 7.8	10.754	2.954
1983	18.535	.....	.....	10.166	.....	.....	.....
1982	18.812	.....	.....	.....	.....	.....	.....
1981	17.316	.....	.....	.....	.....	.....	.....

[1] Unweighted earnings rate of the top 50 stock life companies in the current year.

[2] Preceding three-year average of the stock earnings rate.

[3] Equal to 0.9055 of the current stock earnings rate (CSER), since the imputed earnings rate is .165 times the ratio of the CSER divided by the base period (1981–3) stock earnings rate (18.221).

[4] Equal to the imputed earnings rate minus the average mutual earnings rate from two years earlier.

[5] Equal to the imputed earnings rate minus the average mutual earnings rate from the same year.

[6] Tentative.

[7] In Notice 88–106, 1988–40 I.R.B.1, the IRS stated that Treasury regulations will provide that the differential earnings rate and the recomputed differential earnings rate may not be negative.

[8] Set by statute.

Source: IRS, Revenue Ruling 87–98 and Announcement 88–47. Department of the Treasury, Office of Tax Analysis, June 1988.

Treatment of stock life insurance subsidiaries

Certain modifications to the equity base are required if a mutual life insurance company owns one or more subsidiaries that are life insurance companies. Such subsidiaries are generally treated as stock life insurance companies in computing such subsidiaries' entity level income tax liability. However, for purposes of computing the differential earnings amount, a mutual parent of a subsidiary life insurance company is required to include the equity of such company in its own equity base (in lieu of the value of the stock of the subsidiary).

For purposes of determining the statement gain or loss from operations of the mutual parent, the mutual parent does not take into account any dividends it receives from the subsidiary. Also, for purposes of computing the average mutual earnings rate and the imputed earnings rate, life insurance subsidiaries of a mutual life insurance company are treated as mutual companies. If a subsidiary life insurance company is owned by more than one mutual entity and is not a member of an affiliated group, the Secretary is to provide adjustments that are to be made in the equity bases of mutual life insurance companies owning stock therein to carry out the general rules described above.

This treatment is in contrast to the treatment of nonlife insurance subsidiaries, the stock of which is included in the parent mutual company's equity and the earnings of which are only taken into account in computing the average mutual earnings rate when and as dividends are received by the parent mutual company.

E. Studies Required by the 1984 Act

Two issues that were of concern during the modification of the structure of life insurance company taxation in 1984 were (1) the amount of Federal income tax paid by the life insurance industry, and (2) the relative Federal income tax burden borne by mutual life insurance companies and stock life insurance companies. The Congress determined that these two issues should be closely scrutinized, and, thus, the 1984 Act instructed the Treasury Department to prepare reports on these issues.

Beginning in 1985, the Secretary of the Treasury was required to submit an annual report on the revenues received under the life insurance provisions for the most recent taxable year. Each report was to be submitted to the House Committee on Ways and Means and the Senate Committee on Finance. Each report was to present the aggregate amount of revenue received for the most recent taxable year for which data were available. The revenue received was to be compared with the revenue anticipated as a result of the changes made by TEFRA in 1982 and the 1984 Act. In addition, the report was to provide the reasons for any difference between the actual revenue received and the revenue anticipated when the Acts were adopted. An analysis of revenue collected from life insurance companies was included in the interim report submitted by the Treasury Department to the Congress on June 15, 1988.[5]

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[5] Department of the Treasury, *Interim Report to the Congress on Life Insurance Company Taxation*, June 1988.

The Secretary of the Treasury, in consultation with the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation, was also instructed to conduct a study of the effects of the provisions of the 1984 Act on the different segments and products of the life insurance industry during 1984, 1985, and 1986.

This study was to include an analysis of the relative shares of life insurance company taxes paid by mutual life insurance companies and stock life insurance companies. The study was also to consider any other data considered to be relevant by either stock or mutual life insurance companies in determining appropriate segment balance. Among the relevant variables for consideration were the amounts of the following items for each segment of the industry: equity, life insurance reserves, other types of reserves, dividends paid to policyholders and shareholders, pension business, total assets, and gross receipts. Also, in preparing this study, the Treasury Department was to address the revenue impact of allowing consolidated returns to be filed by life insurance companies with nonlife or noninsurance companies. The study was to include an analysis of to what extent taxes paid by stockholders of life insurance companies affect proper evaluation of segment balance.

Finally, the study was to include an analysis of life insurance products and their taxation and an analysis of whether the tax provisions in part I of subchapter L operate as a disincentive to growing companies.

In order to conduct the study with as much information as possible, the Secretary of the Treasury was provided authority to require the reporting of data by life insurance companies. Also, it was specifically provided that the general authority granted to the Treasury to gather information could be used to gather information on the volume and use of policyholder loans so that the committees would have useful information for future legislative work in that area.

The final report on the study is to be submitted by January 1, 1989, to the Committee on Ways and Means and the Committee on Finance. Interim reports were to be submitted to the committees not later than July 1, 1986, July 1, 1987, and July 1, 1988. The first interim report was transmitted to the Ways and Means and Finance Committees on June 15, 1988.[6] A summary of the June 1988 Treasury Department Report is in Part III, below.

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[6] *Id.*

III. SUMMARY OF 1988 TREASURY DEPARTMENT INTERIM REPORT ON LIFE INSURANCE COMPANY TAXATION

A. 1987 Treasury Survey

Background

The 1984 Act required the Treasury Department to submit reports on the Federal income taxes paid by the life insurance industry and the relative tax shares paid by the mutual and stock company segments. To comply with the 1984 Act, the Treasury Department in 1987 conducted a special survey of life insurance companies. The results of this survey were presented in an interim report submitted to the Congress on June 15, 1988.[7]

Survey design

The Treasury Department in June 1987 sent questionnaires to the 50 largest mutual and 198 largest stock life insurance affiliated company groups; the survey also was sent to a random sample of smaller mutual and stock company groups.[8] The survey excluded Canadian-owned, tax-exempt, and bankrupt life insurance companies, and companies not taxed as life insurance companies for Federal income tax purposes. A total of 322 companies were surveyed with a final response rate of 98 percent. The figures presented in the Treasury Report were computed by weighting the survey data for each of the four sample groups (small and large mutual and stock companies) by the sample rate for the group.

Comparability with IRS and financial statement data

The survey data contained in the Treasury Report are not directly comparable to published data from IRS statistics of income or financial statements. First, Federal income tax rules were used to classify firms as life insurance companies. Second, the provision for taxes shown on financial statements generally is not the same as the amount reported on tax returns. Third, the survey data may be used to show tax information for life insurance companies before consolidation with nonlife affiliates.

B. Revenue Effect of 1984 Act

Background

The 1984 Act directed Treasury to submit annual reports to Congress on life insurance company tax revenues. These reports were to: (1) compare the actual amount of revenue received from life in-

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[7] Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation*, June 1988.

[8] Asset data from A.M. Best Company, *1985 Life and Health Balance Sheet and Income Statement Tape* ("Best Tape") were used to rank company groups by size.

surance companies with the amount of revenue that was anticipated to be received from these companies during the consideration of the Tax Equity and Fiscal Responsibility Act of 1982 ("1982 Act") and the 1984 Act; and (2) explain any differences between actual and anticipated revenues.

Anticipated revenues

The Treasury Department estimates the revenue effect of tax legislation relative to a baseline revenue forecast. The baseline is a current forecast of revenues that would be received if present law were not amended. The Treasury Department revenue baseline utilizes the macroeconomic projections published by the Office of Management and Budget.

The revenue effect of a tax bill is the estimated change in revenues relative to the baseline forecast. Consequently, the revenue "anticipated" to be received if a tax bill is enacted is the sum of the baseline revenue forecast plus the estimated revenue effect of the bill.

Anticipated revenues may diverge from actual revenues because either the baseline revenue forecast or the estimated revenue effect is inaccurate. Because the revenues that would have been received had enacted legislation not been adopted cannot be measured, the degree to which differences between anticipated and actual revenue are attributable to error in the baseline versus error in the revenue estimate cannot be determined precisely.

Errors in forecasting baseline revenues may be caused by incorrect projections of macroeconomic variables such as interest rates, inflation, and GNP growth. Baseline revenue forecasts for a particular industry also are prone to error when the industry's competitive environment is undergoing rapid change (for example, when new products are introduced or new firms enter the industry).

Error in estimating revenue effects can be caused by incorrect projections of macroeconomic variables as well as insufficient data. In addition, behavioral responses to new tax rules are extremely difficult to predict and may be a source of error in revenue estimates.

Treasury Department estimates of 1984 Act

Table 2, below, illustrates the Treasury Department's estimates of life insurance industry tax receipts before and after the 1984 Act, calculated as of June 1984. The Treasury Department estimated that the 1984 Act would reduce aggregate tax receipts from life insurance companies by $0.5 billion in fiscal 1984, with the revenue loss increasing to $1.2 billion by fiscal 1988. After taking into account the changes in the 1984 Act, life insurance company tax receipts were projected to be $2.5 billion in fiscal 1984, increasing to $3.8 billion in fiscal 1988.

The Treasury Department baseline estimates were determined on a life subgroup basis, i.e., excluding income of affiliated nonlife companies, but taking into account the use of losses and credits from affiliated nonlife companies against the income and tax liability of affiliated life insurance companies.

Table 2.—Life Insurance Company Tax Liability After the 1984 Act: Comparsion of Treasury Estimate of June 1984 with Preliminary Results from 1987 Treasury Department Survey

[In billions of dollars]

Item	1984	1985	1986	1987	1988
Fiscal Years					
Baseline before 1984 Act..	3.0	4.0	4.3	4.6	5.0
1984 Act Changes	−0.5	−0.9	−1.0	−1.1	−1.2
Baseline after 1984 Act.....	2.5	3.1	3.3	3.5	3.8
Calendar Years					
Baseline after 1984 Act.....	3.0	3.2	.....		
Tax after credits, per survey[1].....	2.4	2.9	.....		
Difference between baseline receipts and survey	−0.6	−0.3	.....		

[1] Includes companies that file separate, life/life consolidated, or life/nonlife consolidated returns. Tax computed after losses and credits from nonlife affiliates.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 12, 15.

The Treasury Department's baseline receipts forecast for the life insurance industry immediately after the 1984 Act may be compared with taxes paid by the life insurance industry in 1984 and 1985, as determined in the Treasury Report. For calendar year 1984, the Treasury Report indicates a revenue shortfall of $0.6 billion: $2.4 billion of tax after credits as compared to the $3.0 billion that had been estimated in June 1984 (see Table 2). For calendar year 1985, the shortfall was $0.3 billion: $2.9 billion of tax after credits as compared to $3.2 billion estimated in June 1984.

Reasons for revenue shortfall

The source of the shortfall in anticipated revenues from the life insurance industry in 1984 is itemized in Table 3, below. For stock life insurance companies (excluding stock subsidiaries of mutual life insurance companies), the Treasury Department overestimated both gain from operations and tax deductions (especially the allowable policyholder dividend and net operating loss deductions). As a result of these offsetting errors, the Treasury Department's estimate of the stock segment's tax liability for calendar year 1984 closely conforms to the taxes actually paid by that segment.

Table 3.—Details of Life Insurance Industry Tax Liability, Calendar Year 1984

[In billions of dollars]

Item	Treasury Estimate of 1984 Act (June 1984)			Preliminary Result from 1987 Survey [1]		
	Mutual	Stock	Total	Mutual	Stock	Total
Gain from operations [2]	10.7	6.0	16.7	11.3	10.2	21.5
Total deductions	6.6	3.0	9.6	9.1	7.0	15.9
Allowed policyholder dividend deduction [3]	5.6	1.7	7.3	8.0	4.2	12.2
Net operating loss deduction	([4])	0.4	0.4	0.4	1.7	2.0
Small business deduction	([4])	0.2	0.2	0.1	0.2	0.2
Special life insurance deduction	1.0	0.7	1.7	0.6	0.9	1.5
Net income less deficit	4.1	3.0	7.1	2.2	3.2	5.6
Taxable income	4.2	3.1	7.3	2.3	3.4	5.7
Tax before credits	1.9	1.4	3.3	1.0	1.4	2.4
Less: Credits	0.3	0.1	0.4	([4])	([4])	0.1
Tax after credits	1.6	1.4	3.0	1.0	1.4	2.4

[1] Includes companies that file separate, life/life consolidated, or life/nonlife consolidated returns. Stock life subsidiaries of mutual life companies are classified as mutual life insurance companies.

[2] Before policyholder dividend and net operating loss deductions and after income offset by nonlife losses.

[3] Treasury estimate of mutual segment's allowable policyholder dividends assumed a $37.4 billion equity base and a 16.5% applicable imputed earnings rate.

[4] Less than $50 million.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 13–14.

For mutual life insurance companies, the shortfall in the Treasury Department's estimate of anticipated revenues is primarily due to a $2.4 billion underestimate of allowable policyholder dividends and a $0.4 billion underestimate of net operating loss deductions. The Treasury Department attributes $0.4 billion of the $2.4 billion underestimate of allowable policyholder dividends to an overestimate of the mutual segment's average equity base. The 1984 estimate assumed an average equity base of $37.4 billion, while the

actual average equity base reported to the Treasury Department for 1984 was $32.1 billion.[9]

The Treasury Department explains the overestimate of the 1984 mutual equity base as follows:

> First, the estimated equity was based on the "industry's" regulatory data which differs in scope and measurement from the tax definition used in section 809. The regulatory definition is generally broader than the tax definition. Second, the possible tax-minimizing behavior on the part of the mutual segment in reducing their equity as measured for section 809 purposes may have been underestimated.[10]

The Treasury Department explains its underestimate of net operating loss deductions in 1984 and 1985 as due to the pre-1984 Act baseline's failure to account fully for the temporary relief provisions in the 1982 Act, the availability of consolidation after 1980, and the recession in 1982–1983. The Treasury report states:

> The temporary relief provisions removed the limitation on deductions of policyholder dividends contained in the 1959 Act, permitting the accumulation of large net operating losses in 1982 and 1983. Some of these net operating losses were carried forward as deductions in 1984 and 1985 . . . [T]his effect of the 1982 Act was not apparent at the time the revenue estimates were made for the 1984 Act.[11]

Segment balance

The Treasury Department's original estimates of the 1984 Act assumed that approximately 55 percent of life insurance industry tax revenues would be derived from the mutual segment of the life insurance industry and the remaining 45 percent from the stock segment. The Treasury Report shows that in actuality the balance of tax liability between the segments is the reverse of what was originally anticipated for 1984 and 1985; approximately 45 percent of tax liability was derived from the mutual segment while the remaining 55 percent was derived from the stock segment (see Table 4, below). If the mutual segment's tax liability is adjusted for "true-ups" occurring in the following tax year, the segment balance is erratic.

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[9] Under section 809, allowable policyholder dividends are reduced by the product of the differential earnings rate and the mutual equity base. Thus, a $5.3 billion overestimate of the mutual equity base translates into a $0.4 billion underestimate of allowable policyholder dividends at the 1984 differential earnings rate of 7.8 percent.

[10] Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), p. 16.

[11] *Id*, p. 15.

Table 4.—Life Insurance Segment Balance, Calendar Years 1984-1985: Comparsion of Treasury Estimate of June 1984 with Preliminary Results from 1987 Treasury Department Survey

Item	Mutual [1]	Stock	Total
Calendar Year 1984			
Treasury Estimate, June 1984			
Amount (billions)	$1.6	$1.4	$3.0
Percent	53	47	100
Treasury Survey, 1987			
Before "true-up":			
Amount (billions)	$1.0	$1.4	$2.4
Percent	42	58	100
After "true-up":			
Amount (billions)	$1.35	$1.4	$2.75
— Percent	49	51	100
Calendar Year 1985			
Treasury Estimate, June 1984			
Amount (billions)	$1.7	$1.4	$3.2
Percent	55	45	100
Treasury Survey, 1987			
Before "true-up":			
Amount (billions)	$1.3	$1.6	$2.9
Percent	45	55	100
After "true-up":			
Amount (billions)	$0.6	$1.6	$2.2
Percent	27	73	100

[1] Includes stock subsidiaries of mutual life companies.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 13-17.

The Treasury Report concludes that the greater than expected tax liability of the stock segment for 1985 is primarily attributable to the large amount of capital gains realized in that year. The Treasury Report also concludes that the overestimate of the mutual segment's tax liability for 1985 is explained by a combination of factors including (1) lower than expected earnings growth; (2) larger than expected net operating losses; and (3) larger than expected policyholder dividend deductions, as was the case for 1984

The Treasury Report states that the policyholder dividend deduction appears to have been underestimated as a result of a smaller than expected mutual equity base and a larger than expected stock earnings rate (unweighted earnings rate of the top 50 stock life companies) during the base period (1981-1983).[12] The Treasury Report speculates that the lower than expected earnings growth of the mutual segment could be due to a change in the mutual segment's share of the insurance market, which was not contemplated

[12] The base period stock earnings rate enters into the denominator of the imputed earnings rate: a larger than expected base period stock earnings rate causes a smaller imputed earnings rate; a smaller differential earnings rate; and thus a larger policyholder dividend deduction than expected.

in the 1984 baseline, or to tax-minimizing behavior not taken into account in the 1984 revenue estimate.

Treasury Report conclusion

The Treasury Report concludes that tax payments of the life insurance industry and the relative shares paid by the mutual and stock segments in 1984 and 1985 did not meet Congressional expectations at the time of the 1984 Act. The report states:

> In part, these shortfalls are attributable to: (1) the complexity of the life insurance industry and their [sic] tax rules; (2) the significant changes in the practices, products, and tax rules during the last decade; and (3) the possible underestimation of the industry's tax minimizing behavior in response to changes in the 1982 and 1984 Acts.[13]

The Treasury Report does not contain any conclusions regarding the data. The report states ". . . it is more appropriate for tax legislation to attempt to measure accurately the taxable income of companies than to attempt to collect a particular amount of revenue from an industry or from the different segments of an indutry."[14]

Several factors should be considered in the interpretation of the data contained in the Treasury Report. First, the data are preliminary and have not been fully verified by the Treasury Department. Second, the data do not reflect amendments and audit adjustments to 1984 and 1985 tax returns made after the date of the Treasury survey. Third, the revenue estimates are shown on a consolidated basis, whereas the Treasury Report states that "... it may be appropriate to examine the [effect of] tax law ... [on] the life subgroup before consolidation with non-life companies."[15] Fourth, the data do not include taxes paid by stockholders of life insurance companies (policyholders in the case of mutual life companies) with respect to such stock. Last, tax minimizing behavior in the life insurance sector, such as an increase in tax-exempt bond ownership, may increase tax liability in other sectors (as a result of reduced ownership of tax-exempt bonds in these sectors). Thus, a portion of the revenue change attributable to the insurance provisions of the 1984 Act could be reflected on the tax returns of taxpayers other than life insurance companies.

C. Historical Data Relating to Life Insurance Company Segment Balance

Background

The Deficit Reduction Act of 1984 directed the Treasury Department to submit to Congress three interim reports and a final report with respect to life insurance company segment balance. Among other things, these reports were to include: (1) an analysis of the portion of the taxes paid by mutual and stock life insurance

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[13] Treasury Report, p. 18.
[14] *Id.*
[15] *Id.*, p. 15.

companies; and (2) any other data relating to segment balance such as equity, reserves, dividends, pension business, total assets, and gross receipts.

Historical segment balance data

The 1987 Treasury survey of life insurance companies only collected information for 1984 and 1985. Therefore, the Treasury Report relied on financial statement data to analyze trends in segment balance. For this purpose, the American Council on Life Insurance ("ACLI") tabulated information on financial statements with adjustments to (1) include U.S. branches of Canadian companies, (2) exclude companies not taxable as life insurance companies, and (3) include stock company subsidiaries of mutual companies in the totals for mutual companies.

Table 5 contains segment data on life insurance premium income and gross assets for 1970 through 1984. Both the premium and asset data illustrate that the life insurance industry has grown substantially between 1970 and 1984, and that the stock segment has grown more rapidly than the mutual segment. Over the 1970-1984 period, mutual company premiums increased 8.1 percent annually and mutual company assets increased 7.7 percent annually. By contrast, over the same period, stock company premiums increased 11.2 percent annually and stock company assets increased 11.8 percent annually. As a result, over the 1970-1984 period, the mutual company share of premium income declined from 53 to 43 percent, and the mutual company share of assets declined from 68 to 56 percent.

The mutual company share of premium income is consistently lower than the mutual company share of assets. The Treasury Report attributes this to the fact that mutual companies issue a higher proportion of cash value life insurance than stock companies.

Table 5.—Assets and Premium Income of All Life Insurance Companies, 1970–1984, Tabulated by the American Council on Life Insurance[1]

[Dollar amounts in billions]

Year	Premium Income				Gross Assets			
	Amount		Percent		Amount		Percent	
	Mutual	Stock	Mutual	Stock	Mutual	Stock	Mutual	Stock
1970	$19.3	$17.1	53.0	47.0	$142.0	$65.4	68.5	31.5
1971	21.2	19.2	52.5	47.5	150.4	71.6	67.7	32.3
1972	22.8	21.2	51.8	48.2	160.8	78.5	67.2	32.8
1973	24.6	23.6	51.0	49.0	166.9	84.6	66.4	33.6
1974	26.5	25.4	51.1	48.9	172.7	89.4	65.9	34.1
1975	29.5	28.4	50.9	49.1	188.0	99.6	65.4	34.6
1976	33.0	32.6	50.3	49.7	206.1	112.9	64.6	35.4
1977	35.6	35.6	50.0	50.0	221.8	126.5	63.7	36.3
1978	38.4	39.4	49.4	50.6	241.9	143.7	62.7	37.3
1979	40.0	43.8	47.7	52.3	264.2	163.3	61.8	38.2
1980	41.5	49.8	45.5	54.5	288.8	184.7	61.0	39.0

Table 5.—Assets and Premium Income of All Life Insurance Companies, 1970–1984, Tabulated by the American Council on Life Insurance[1] —Continued

[Dollar amounts in billions]

Year	Premium Income				Gross Assets			
	Amount		Percent		Amount		Percent	
	Mutual	Stock	Mutual	Stock	Mutual	Stock	Mutual	Stock
1981	41.1	63.1	39.4	60.6	309.0	210.1	59.5	40.5
1982	44.0	75.0	37.0	63.0	336.2	243.7	58.0	42.0
1983	47.1	70.4	40.1	59.9	366.2	277.9	56.9	43.1
1984	57.8	75.6	43.3	56.7	401.2	311.5	56.3	43.7
Growth rate, 1970–1984 (percent)	8.1	11.2	.....		7.7	11.8	.....	

[1] Tabulated from annual statements and Best's Reports by ACLI. Annual statement information adjusted to exclude amounts for companies not taxable as life insurance companies, to include amounts for U.S. branches of Canadian companies, and to include amounts for stock subsidiaries of mutual life insurance companies in the totals for mutual life insurance companies.

NOTE.—These data may not be comparable to the 1987 Treasury Department survey.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 45, 50.

Segment balance data for 1985

The 1987 Treasury Department survey collected segment balance information from a large sample of life insurance companies for 1984 and 1985. The 1987 Treasury Department survey shows that, for 1985, the mutual company share of premium income was 44.1 percent and the mutual company share of gross assets was 55.8 percent (see Table 6, below). These data are very similar to the 1984 data compiled by ACLI (see Table 5).

Table 6.—Life Insurance Company Segment Balance Data Tabulated from 1987 Treasury Survey, 1985 [1]

[Dollar amounts in billions]

Item	Amount			Percent		
	Mutual	Stock	Total	Mutual	Stock	Total
Information from Forms 1120 and 1120L [2]						
Taxable income:						
After nonlife losses	$3.398	$4.034	$7.432	45.7	54.3	100.0
Before nonlife losses	3.627	5.076	8.703	41.7	58.3	100.0
Tax before credits:						
After nonlife losses	1.373	1.648	3.022	45.4	54.6	100.0
Before nonlife losses	1.482	2.119	3.601	41.2	58.8	100.0
Tax after credits:						
After nonlife losses	1.282	1.601	2.883	44.5	55.5	100.0
Information from Form 8390 or Annual Statement [2]						
Gross assets	449.7	356.5	806.2	55.8	44.2	100.0
Equity [3]	34.1	44.9	79.0	43.2	56.8	100.0
Information from Form 1120L						
Gross less return premiums	72.1	91.2	163.3	44.1	55.9	100.0
Life insurance reserves [4]	251.9	171.1	423.0	59.6	40.4	100.0
Other reserves [4]	91.0	68.8	159.8	56.9	43.1	100.0
Information from Annual Statements						
Federal income tax incurred:						
Including capital gain	2.081	2.278	4.359	47.7	52.3	100.0
Excluding capital gain	1.414	1.830	3.244	43.6	56.4	100.0
Insurance in force	3,301	3,898	7,199	45.9	54.1	100.0

[1] Mutual includes stock subsidiaries of mutual life insurance companies.

[2] Form 1120 is the corporate income tax return, Form 1120L is the income tax return for companies taxed as life insurance companies, and Form 8390 is the information return for determining the differential earnings rate under section 809.

[3] For companies completing Form 8390, equity is the average equity base reported on the survey. For other companies, equity is capital and surplus minus investment in life company subsidaries, plus the average mandatory security valuation reserve, plus one-half of the average provision for policyholder dividends.

[4] Figures are average of beginning and end of year reserves.

Source: Department of the Treasury, *Interim Report to The Congress on Life Insurance Company Taxation* (June 1988), pp. 23, 31.

Table 6 illustrates that before nonlife losses, the mutual company share of Federal income tax liability before credits was approximately 41 percent in 1985. After consolidating nonlife losses, however, the mutual company share of tax liability was 45 percent. The implication of these data is that stock companies are able to shelter a higher proportion of life insurance company income with nonlife affiliate losses.

Table 6 also shows that taxes reported on financial statements are higher than tax liability shown on income tax returns. The Treasury Report notes that taxes on financial statements are estimates of tax liability and may include deferred tax reserves to allow for timing differences and for audit adjustments. Consolidation on financial and regulatory statements also may differ from consolidation permitted on tax returns.

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